CORPORATE GOVERNANCE AND THE FINANCIAL FAILURE

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ABSTRACT

This study aims at examining the effect of corporate governance on revealing the financial failure of Jordanian Public Joint-Stock Companies. Two independent variables were specified: determining board of director responsibility and disclosure. Meantime, the dependant variable was revealing the financial failure. The study population consisted of (100) industrial companies and it depended on the randomized sample. The sample taken out for the study consisted of 50% of the total study population. The researchers distributed 50 questionnaires out of which 45 valid for statistical analysis were received. The study employed the Statistical Package for the Social Science (SPSS) Version 17 for windows, data was analyzed through: the use of descriptive statistics methods, reliability analysis, and regression. The study made a number of conclusions, most importantly: There is statistically significant effect to determine the responsibilities of the Board of Directors of the company; disclosure on revealing the financial failure. Based on such results, the researchers proposed some recommendations such as: Attention should be given to determine the authorities and responsibilities of all the management personals of the company, so that it can be possible to determine who is responsible for the financial failure.

Keywords: Corporate governance, financial failure, industrial joint-stock companies, Jordan.

INTRODUCTION

Corporate governance became one of the main requirements of the sound management among companies throughout the world. It is also one of the company continuity mechanisms through enhancing the principles transparency, disclosure, monitoring, accountability, and determining responsibilities in a way providing suitable climates to achieve the vision and objectives of the company, and guarantee the effective and efficient utilization of the resources. Accordingly, the importance of corporate governance in the company is based on the fact that it provides a foundation for development and future performance of the company for the aim of supporting and reinforcement of trust throughout the company as an investment pool for the shareholders.

The importance of applying the governance principle had increased among the companies in the era of globalization, economical openness, and the crisis resulting from the management malpractices. The previous years showed that the economics of many countries had stumbled as a result of the lack of good governance, which in turn resulted in heavy damages for the shareholders, creditors, suppliers and others.

In Jordan, the Companies Control Department indicate that the accumulative number of the companies which were dissolved till end of June 2010 was (28808) companies with total capitals amounting (545) million Jordanian Dinars or equivalent to ($778) million. Many of these companies were dissolved as a result of the entire loss of capital, corrosion of the shareholders equities and mismanagement

Since, sound corporate governance provides to the board of directors and executive management of the company with the suitable tools and methods to approach the strategic goals; guarantees finding a controllable, effective work environment, and subsequently, assist the company to utilize its resources effectively; employs them in an optimal manner; maintains its success and continuity, this study has been prepared to examine the effect of determining the board of directors responsibilities and disclosure on revealing financial failure in the Jordanian industrial joint-stock companies.

LITERATURE REVIEW

The International Organization for Economic Cooperation and Development (OECD) defined governance as a number of rule, principles, and criteria that organize the relation between the management and shareholders, for the aim of facilitating control and supervision on the interests of the shareholders, and achieve the optimal utilization of the company resources and assets (OECD, 1999). Shihata, (2007) defined it as a number of rules and criteria that determine the companies work practices within the markets in terms of the bases for decision making and transparency of offering the financial statements and accounting criterions applied inside the company setting; as well as the extent of providing the data by the management to all of the investors.

Al-Mutairi, (2003) defined it as a number of procedure organizing the works of the companies so as to achieve an equilibrium between the equities of the contradictory interests of stakeholders.

Solomon (2007) defined it as process aiming to make sure that the management is working for achieving the goals of the owners through supervision and surveillance over this management, in accordance with rules and criteria that management should adhere to.

Meantime, Union of Arab Banks (2003, p. 42) defined it as a number of criterions that realize balance between the individual and corporate goals, as well as between the economical and social goals.

Based on the above particulars, the researchers of this paper conclude that those former researchers who dealt with this issue did not reach an agreement over a unified definition of corporate governance. Yet, they agree on that it’s a pool of criteria, principles and rules that govern the nature of the decisions the management may make, so that it could be decided whether or not the management is responsible for the failure through its commitment extent to the principles of the corporate governance, which basic goal is achieving the objectives of the stakeholders in that company.

Several studies dealt in the corporate governance in companies. In this concern, Qabaja, (2008) concluded a positive relationship between the effectiveness of applying the principles of governance, and the return on equities, return on investment, and market value as compared by the book value. In the meantime, there was an inverse relationship with the share daily price. In the study made by Goh, (2003) he examined the effect of ownership structure and the dispute of the interests of the shareholders on the performance of the companies in the shade of the corporate governance weakness in Korea. He concluded that the drop in the ownership focus rate negatively affects profitability and control systems, and increases the risks and interest contradiction among the shareholders. He further concluded that the weakness of governance led into the emergence of a poor management. In the study made by Abu Zirr (2006), she attempted to present a strategy that helps the Jordanian banking sector improve the effectiveness of the corporate governance. She further concluded that there is a shortcoming in the published statements in terms of disclosure in conformity with the Basle Commission (1999); and that there is consistency between the governance criteria issued by OECD (2004) and the Jordanian legislations. In this concern, Ibrahim, (2009) examined the effect of the practices of the corporate governance on the company competitiveness. He found that the Jordanian companies are applying the governance to a high degree in terms of the disclosure, transparency, responsibility of the board of the directors, and the shareholders equities; and to a medium degree in terms of the criterion of the practices of the stakeholders, and the equal treatment of the shareholders. In the same direction, Mangena and Pike, (2005) a study and came out with the following finding: There is a positive statistically significant relationship between experience in the financial affairs and level of disclosure.

In a study by Dahmash (2003), he concluded that there must be a substantial examination to the nature of the relation between auditors and companies' management, especially the board of directors, in order to restore the trust between the investors, employees, banks and creditors. He maintained that manipulations and fraudulence existed, which affected the trust of these categories in the company management and the auditors; and there we need a long time to restore this trust. He further found that the solution is to apply the corporate governance principles. Among the other findings of this study, the researcher found that some auditing companies were carrying out double-faced acts in favor of the customers, which is deemed a breach to the governance and ethics of the auditing profession at large. He also indicated that there is a delinquency of the financial markets in the surveillance over the companies.

In the study of Bhagat & Bolton (2008), the researchers found that separation between the CEO position and the chairman of the board of directors is connected with the optimal performance in a positive manner; that there is a direct correlation between the increase of the share ownership of the members of the board and the good performance; and that the independence of the members of the board negatively affects the performance.

In this concern, Abu Saadeh (2009) concluded that the application of corporate governance concept has and influence on the strategies for the management of the human resources; and there are internal and external reasons that call the companies for the application of the corporate governance criteria, such as disclosure and transparency to gain the trust of the investors.

In the study made by Khalil, (2009), he identified a model for developing a balanced measurement of performance that is in line with the corporate governance principles, the most important of which is the principle of transparency of the date that could be obtained to develop the balanced measurement of performance.

Al-Jobouri (2007), concluded that there is an urgent need to apply corporate governance criteria, especially the disclosure and transparency, for the aim of combating the financial and administrative corruption. Subsequently, there will be a realization of the administrative efficiency in managing the economical resources of the companies.

Finally, the Union of the Arab Banks, (2003), in its study in this regard, found that the corporate governance gains extreme importance following the international financial crisis; and that the corporate governance in the Arab banks is suffering from many gaps, particularly those concerning the disclosure of the data and the organizing relation among the different managements of the companies.

As may be seen in the studies that were cited, they did not examine the relationship between determining the responsibility of board of directors, transparency criteria (the independent variable) and revealing of the financial failure (the dependent variable). As a result, this was among the most important justification for conducting the current study.

RESEARCH MODEL AND HYPOTHESES

This study seeks to test the following hypotheses:

H01: There is no effect of determining the responsibilities of the board of directors on revealing the financial failure; and

H02: There is no effect of disclosure on revealing financial failure.

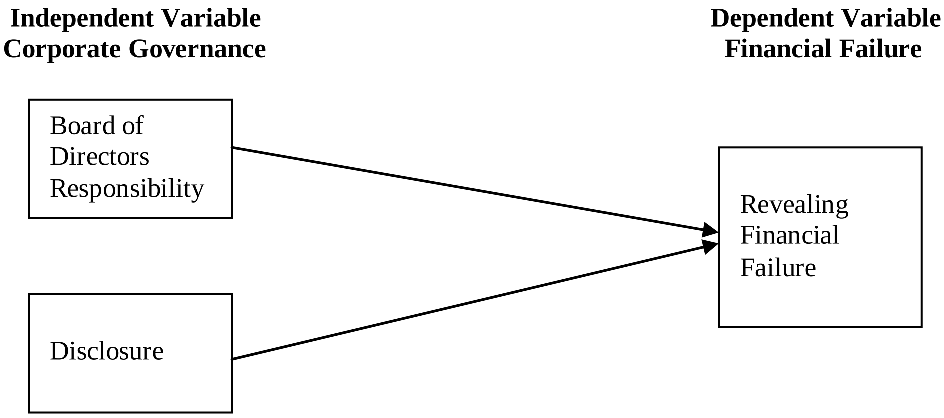

Figure 1: Research Model

RESEARCH METHODOLOGY

Study Population and Sample

The study populations consisted of the Jordanian public joint-stock industrial companies at Amman Stock Exchange (Bourse), which amounted 100 hundred companies till 2010, as per the information taken from Amman Bourse and the Library of Jordan Securities Commission. Meanwhile, the study sample consisted of (50) public, joint-stock, industrial companies, which were selected based on the random sample method. Accordingly the study sample represented (50%) of the total study population, a rate that is suitable for the purposes of achieving such research works (Zikmound, 2000). Fifty questionnaires were distributed to the general managers of these companies, (48) were returned, and (3) were excluded due to their invalidity for analysis. Accordingly, the total number of the questionnaires that were suitable for analysis amounted (45).

Research Procedures and Statistical Treatment

Data analyses and processing were carried out using the statistical package for the social sciences (SPSS) version 17 for windows; frequencies, percentages; means and SD's (standard deviations) were employed to describe the study sample and to identify the attitudes of the study sample about the variables of the study in general; and the regression analysis was performed to measure the effect of the independent variables on the dependent one.

Demographic Characteristics of the Sample

To identify the demographic characteristics of the study sample, the researchers used the frequencies and percentages, which were as follows:

Characteristics of Study Sample

Results of table (1) exemplified that respondents are in general of the males category (n=43 or 95.5%), within the (40-49) years of age group (n=25 or 55.5%), holding bachelor degree (n=30 or 66.6%) and having experience in their current jobs between (6-10), (n=25 or 55.5%).

Table 1: Characteristics of Study Sample

Variable	Category	Frequency	Percent
Gender	Male	43	95.5
	Female	2	4.5
Age	Less than 30 years	2	4.5
	30-39 years	16	35.5
	40 – 49 years	25	55.5
	More than 49 Years	2	4.5
Educational Level	Bachelor	30	66.6
	Diploma	5	11.1
	Master	8	17.7
	Doctorate	2	6.6
Years of Experience	1-5 Years	5	11.1
	6- 10 Years	25	55.5
	11-15 Years	10	22.3
	More than 15 Years	5	11.1
Total Number of Respondents		45	100%

Construct Reliability

Reliability analysis was performed in order to ensure the internal consistency and stability of items used to measure the independent and dependent variables. For the purpose of this study, a minimum internal reliability coefficient or alpha value of 0.7 was adopted. According to Hair, Anderson, Tatham and Black (1998), value of 0.7 can be considered adequate if the study is exploratory in nature as in this case. The alpha values for all items were 0.737 and thus considered reliable. Table (2) shows the reliability analysis result.

Table 2: Reliability Statistics

Cronbach's Alpha	Number of Cases	Number of Items
0.737	45	24

Table (3) represents the mean and standard deviation, among the study variables. It can be inferred that in Jordan, respondents have a positive attitude regarding the principle of corporate governance.

Table 3: Mean Scores and Standard Deviation of Study Variables (n = 45)

Variables	Mean	Std Deviation
Corporate Governance	3.79	0.597
Financial Failure	3.80	0.569

ANALYSES AND DISCUSSION OF RESEARCH HYPOTHESES

The hypotheses were tested as per the rule of thumb that provides to accept the hypothesis if its calculated value was higher than its tabulated value.

Hypothesis One

There is no effect of determining the responsibilities of the board of directors on revealing the financial failure.

To test this hypothesis, the researchers used the simple linear regression method to find the relationship and effect between determining the responsibilities of the company board of directors and revealing financial failure, as shown in Table (4)

Table 4: Simple Regression Analysis of the Effect of Company Board of Directors Responsibilities on Revealing the Financial Failure

R Correlation	R^2 Coefficient of Determination	F Calculated	F Tabulated	β Regression Coefficient	*Sig. Significance Level
0.606	0.367	93.545	3.89	2.169	0.000

*Correlation will be of statistical significance at the level ($\alpha \leq 0.05$).

Results of the statistical analyses demonstrated a positive, statistically significant effect between determining the responsibilities of the company board of directors and revealing of financial failure, as the correlation coefficient was (0.606) at ($\alpha \leq 0.05$) significance level, with a coefficient of determination amounted to (0.367). Meaning that (0.367) of determining the company board of directors responsibilities can help in revealing financial failure. The effect degree was (2.169), meaning that the increase of one unit in the variables of determining the company board of directors responsibilities will lead into a one degree in revealing financial failure by the value of (2.169).

This is indicative of the existence of a linear relationship between defining the company board of directors' responsibilities (as an independent variable) and revealing of financial failure (as a dependant variable). Thus, further reflects the value of the quantitative effect of the independent variable (determining the responsibilities of the company board of directors) on the dependant variable (revealing financial failure).

The significance of this relationships is further emphasized by the F calculated value amounting to (93.545) which is higher than that of the tabulated (3.89), and in turn, emphasizes the invalidity of hypothesis one. As a result, the null hypothesis is rejected and replaced by the alternative hypothesis stating: there is an effect of determining the responsibilities of the company board of directors on revealing financial failure.

Hypothesis Two

There is no effect of disclosure on revealing financial failure.

Table (4) illustrates the results of testing this hypothesis.

Table 5: Simple Regression Analysis of the Effect of Disclosure on Revealing the Financial Failure

R Correlation	R^2 Coefficient of Determination	F Calculated	F Tabulated	β Regression Coefficient	*Sig. Significance Level
9.324	0.105	18.737	3.89	3.060	0.000

*Correlation will be of statistical significance at the level ($\alpha \leq 0.05$).

Results of the statistical analysis showed a positive effect of disclosure on revealing financial failure, meaning that the statistical significance was positive, as the correlation coefficient was (9.324) at ($\alpha \leq 0.05$) and (0.105) coefficient of determination. Furthermore, meaning that the increase of one unit in the disclosure variables will lead into a one degree in revealing the financial failure by the value of (3.060).

This is indicative of the existence of a linear relationship between defining the disclosure (as an independent variable) and revealing the financial failure (as a dependant variable). Thus, further reflects the value of the quantitative effect of the independent variable (the disclosure) on the dependant variable (revealing the financial failure).

The significance of this relationship is further emphasized by the F calculated value amounting (18.737) which is higher than that of the indexed (3.89), and in turn, emphasizes the invalidity of sub-hypothesis two. As a result, the null hypothesis is rejected and replaced by the substitute hypothesis stating: there is no effect of the disclosure on revealing the financial failure.

CONCLUSIONS

After displaying the results of the statistical analyses, the researchers made the following conclusions:

1. Determining the responsibilities of the board of directors in a clear manner lead to prevent making personal benefits and consequently not affecting the decisions that are concerned with the company itself.
2. The existence of external board of directors helps to establish a better control mechanism to reveal financial failure.

3. Cooperate governance principles are considered one of the most important requirement for successful management and the healing medicine to regain the loss of investors trust.
4. It is extremely important to apply the principles of corporate governance in the companies to assist the country economy grow and prosper, a finding that is quite consistent with the study of Abu Zirr, (2006).

RECOMMENDATIONS

Based on the study conclusions the following recommendations can be made:

1. It is inevitable to find a definite mechanism to compel companies apply principles of corporate governance, due to its importance at the national level in Jordan.
2. Paying special attention to determine the powers and responsibilities of all the management personals of the companies, so that it can be possible to determine the party responsible for failure.
3. It is very important to apply disclosure when issuing the financial statements, as this is of great significance in revealing the financial failure, as well as preclude the various departments use misleading in passing some data and particulars.
4. Conducting studies and research works in an attempt to build a mathematical model to measure the adherence degree of the companies for applying the principles of corporate governance.

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